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Economic Statistics Point Toward Growth In Japan

Not every indicator is showing full speed ahead, but forward motion seems to have resumed for the Japanese economy. That appears to be the consensus prior to the release next month of the third-quarter gross national product statistics. The April-June 1988 GNP data suggested the economy slipped a bit as growth declined at a 3.9 percent annual rate (see JEI Report No. 37B, September 30, 1988). But the drop, partly a result of quirks in the calendar, increasingly looks like an aberration that is being overwhelmed by other developments.

The pessimists, however, find ample evidence to bolster their case. The second-quarter drop in growth was foreshadowed by leading indicator data designed to predict trends. The data gave a reading just below the boom-or-bust threshold of 50. The latest figures, 36.4 for July and 40 for August, are even

Trade Data Show Mixed Results

Japan's trade and current account pictures are getting murkier. While most of the past two years have seen a slow if steady decline in Japan's huge current account and trade surpluses, that result is no longer predictable. The latest statistics, for the June-September quarter, show one surplus smaller and the other larger than a year earlier.

The trade surplus (both exports and imports measured free on board) rose a scant 1.4 percent from a year earlier on a dollar basis (see Table 1). Although imports surged 27.2 percent compared to a 16.5 percent rise in exports, overseas sales increased from a larger base than purchases from abroad, thus widening the gap. Cheaper oil, which reduces the import bill, slowed the growth of imports and contributed to the increase in the surplus. The depreciation of the dollar over the past year also played a role, artificially swelling the value of dollar-denominated exports, imports and the surplus. In contrast to its value in dollars, the trade surplus as measured in yen declined 7.7 percent.

The more comprehensive measure, the current account surplus, was down 10 percent in dollar terms and 17.9 percent in yen terms from the July-September 1987 period. The effects of the marginally larger dollar-denominated trade surplus were overwhelmed by a surge in the services deficit, up 114.5 percent in dollars from a year earlier. Within the services account, higher net foreign investment income, a result of past investment abroad, was swamped by a widening deficit in overseas travel expenditures.

Japan's net investment income is likely to keep rising, if figures on capital flows are any indication. Japan's net long-term capital outflow increased to the highest figure since the second quarter of 1987, in part a consequence of greater confidence among Japanese investors about the short-term prospects for the dollar (see Table 2). With the U.S. currency roughly stable against the yen during the quarter, investors had reason to believe that the advantage of higher returns on dollar-denominated assets overseas would not be wiped out by exchange rate movements. Japanese investors tiptoed back into foreign stock markets, making a net addition to their holdings for the first time this year. While the statistics are imprecise, the United States is believed to account for the lion's share of Japanese foreign investment in both bonds and stocks.

While many Japanese were adding to their holdings abroad, foreigners were reducing their positions in Japan, which also increased the long-term capital outflow. Taking their profits from the run-up in Japanese equity prices, foreigners reduced their stockholdings by $4.9 billion, returning to a two-year-old pattern of net selling of Japanese equities. This year's first quarter had been the single exception to this trend. In addition, bond holdings plummeted $7.7 billion for the latest quarter.

Net capital flows are a factor in exchange rates, with larger outflows creating a supply of yen and a demand for dollars, thereby strengthening the American currency. The recent data suggest that short-term capital, which showed an all-time-high inflow of $10.7 billion in the July-September quarter, is pulling in the opposite direction from long-term capital. Furthermore, the demand for dollars created as American investors reduce their positions in

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1983	$31,454	$145,468	$114,014	$-9,106	$20,799	$-17,700
1984	44,257	168,290	124,033	-7,747	35,003	-49,651
1985	55,986	174,015	118,029	-5,165	49,169	-64,542
1986	92,827	205,591	112,764	-4,932	85,845	-131,461
1987	96,386	224,605	128,219	-5,702	87,015	-136,532
1986: I	14,552	44,813	30,261	-1,145	12,668	-18,990
1986: II	23,922	52,270	28,348	-374	23,099	-28,882
1986: III	26,793	53,859	27,066	-1,922	24,413	-38,410
1986: IV	27,560	54,649	27,089	-1,491	25,665	-45,179
1987: I	23,373	50,515	27,142	-1,348	20,962	-32,209
1987: II	25,038	55,823	30,785	-1,601	22,762	-44,365
1987: III	23,585	56,600	33,015	-1,757	21,189	-22,023
1987: IV	24,390	61,667	37,277	-996	22,102	-37,935
1988: I	21,021	59,345	38,324	-1,337	18,421	-15,142
1988: II	22,448	63,559	41,111	-2,882	18,567	-36,556
1988: III(p)	23,914	65,925	42,011	-3,769	19,076	-41,963

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1983	$22,905	$10,400	$12,505	$2,106	$1,445	$661
1984	56,348	29,575	26,773	1,570	1,519	51
1985	291,338	237,859	53,479	5,484	4,489	995
1986	1,346,989	1,253,965	93,024	20,917	13,869	7,048
1987	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1986: I	251,591	234,330	17,261	2,793	1,[illegible]1	832
1986: II	368,271	343,467	24,804	3,717	2,[illegible]0	1,457
1986: III	357,331	330,980	26,351	6,481	4,473	2,008
1986: IV	369,796	345,188	24,608	7,926	5,175	2,751
1987: I	377,850	354,648	23,202	13,925	9,386	4,539
1987: II	341,880	316,585	25,295	15,277	9,797	5,480
1987: III	325,517	308,421	17,096	21,882	18,370	3,512
1987: IV	228,582	221,290	7,292	19,852	16,509	3,343
1988: I	332,047	318,877	13,170	18,901	19,467	-566
1988: II	401,293	374,371	26,922	20,518	20,643	-125
1988: III(p)	333,473	307,635	25,838	25,166	23,424	1,742

Japan is unlikely to continue indefinitely. All this suggests that portfolio adjustments are less positive for the dollar than the long-term capital outflow figure by itself indicates.

The capital flow and the trade figures are close to mirror images: capital flows are the means by which foreign deficits with Japan are financed. Furthermore, dollar-sustaining capital flows work at cross-purposes with efforts to reduce the trade surplus through increased Japanese imports and reduced exports. The larger the capital flow, the more substantial will be the safety net under the dollar and the less likely that significant movement will occur in the trade figures. But if Japanese investors become reluctant to invest abroad, the dollar would either decline or central banks would have to replace the private flow of funds in the absence of a major improvement in the trade figures. Washington and Tokyo seem to view both these possibilities as unattractive, in part because either alternative could undermine investor confidence further, forcing still more central bank intervention or exchange rate changes.

Officials on both sides of the Pacific clearly are hoping that the yen's past appreciation will reduce Japan's current account surplus before Japanese and other investors pull the safety net from under the dollar. Given the precarious state of progress on the Japanese surplus, this high wire act could get even more exciting in the coming months.

Douglas Ostrom

Diet Works On Tax Reform As Scandal Widens

Despite repeated flare-ups of a stock scandal involving aides to politicians (see JEI Report No. 27B, July 15, 1988), the ruling Liberal Democratic Party finally has won the participation of opposition parties to debate a controversial package of tax reform bills in the lower house of the Diet (see JEI Report No. 29B, July 29, 1988). The Recruit Cosmos Co., Ltd. stock scandal is waxing anew, however, forcing an opposition Diet member to resign and reaching out to taint the Japanese bureaucracy. Nevertheless, the general consensus in Japan is that Prime Minister Noboru Takeshita will win approval of the tax reform measures.

The LDP had planned to hold the final public hearing on the tax reform package in the lower house November 4, but this was scratched after the opposition parties staged another boycott of Diet business, angered that the LDP had refused to agree to a request that three persons involved in the Recruit Cosmos scandal testify under oath before a lower house committee investigating the affair. After several days of talks, the LDP agreed November 2 to produce the witnesses, and the opposition parties agreed to set a date for the final hearing on the tax bills.

No sooner had this deal been made than the Japanese press reported that opposition party members also were involved in the Recruit Cosmos affair. Two Democratic Socialist Party dietmen, one Komeito representative and one Japan Socialist Party member allegedly profited directly or indirectly from the sale